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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Mexico's Border Industrialization Program

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
June 1972

INTELLIGENCE MEMORANDUM

MEXICO'S BORDER INDUSTRIALIZATION PROGRAM

Introduction

1. The Mexican border industrialization program (BIP), under which foreign-owned companies are offered import duty exemptions and other inducements to establish plants along the US-Mexican border, has brought substantial economic gains. Initiated in 1966 in an effort to reduce high unemployment levels in the border area, the program has become an important factor in Mexican export expansion and diversification. Nevertheless, the program faces certain internal and external threats that could seriously limit its future success. This memorandum reviews the program's history, examines its economic impact, and assesses its medium-term prospects.

Discussion

Background

2. The economic health of Mexico's northern border area was seriously jeopardized by termination of the US **bracero** program (Public Law 78) in 1965. At the program's height in the early 1960s, some 177,000 Mexican citizens annually crossed the border to obtain seasonal farm work in the United States. Their remittances of some $40 million annually significantly benefited economic activity in the area. The remittances also contributed substantially to retail sales on the US side of the border, where Mexican citizens of the border area spend 50%-60% of their incomes. Following the program's termination, increased unemployment sharply depressed economic activity in the northern provinces, adversely affecting the US border cities as well. The Mexican government, already faced with

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

a political challenge from the opposition National Action Party in the area, felt that strong corrective action was necessary. To this end, it launched the border industrialization program in 1966.

Genesis of BIP

3. BIP was the brainchild of the then-incumbent Secretary of Industry and Commerce, Octaviano Campos Sales. Campos conceived the idea during a 1965 trip to the Far East, where he observed US-owned plants assembling US-made components for re-export to the United States. These plants had been established after the mid-1950s to take advantage of low foreign wages in performing certain labor-intensive manufacturing processes on products destined for the US market. Such operations are encouraged by US import duty exemptions provided under sections 807.00 and 806.30 of the Tariff Structure of the United States (TSUS). Section 807.00 subjects re-imports of US manufactures exported for assembly or further processing to duty only on the value added abroad, provided that the originally exported goods have not lost their physical identity. Although implemented beginning in 1954, following a US Customs Court decision, this section was not formally enacted until 1963. Section 806.30, enacted in 1956, extends the exemption to metal articles exported for processing and return regardless of changes in their physical identity, provided they are subjected to further processing upon return.

4. The principal statutory basis for the BIP is provided in two June 1966 resolutions by the Mexican government. These resolutions extended the main advantages already accruing to foreign-owned firms located in small duty-free zones in a few northwestern border cities – mainly Tijuana, Mexicali, Nogales, and Aqua Prieta – to a new 12-mile-wide zone along the full length of the US-Mexican border. In both the older duty-free zones and the extended zone, manufacturing and processing operations are exempt from Mexican import duties on material inputs and equipment and from legislation setting minimum shares of material inputs that must be of Mexican origin. Additionally, the firms establishing these operations are exempt from "Mexicanization" legislation requiring varying degrees of Mexican ownership and are accorded all privileges normally granted domestic-owned companies. Firms established in either type of zone are prohibited from selling duty-free materials and finished products in Mexico generally, but those previously established in the duty-free zones are permitted to sell finished products within their zone.

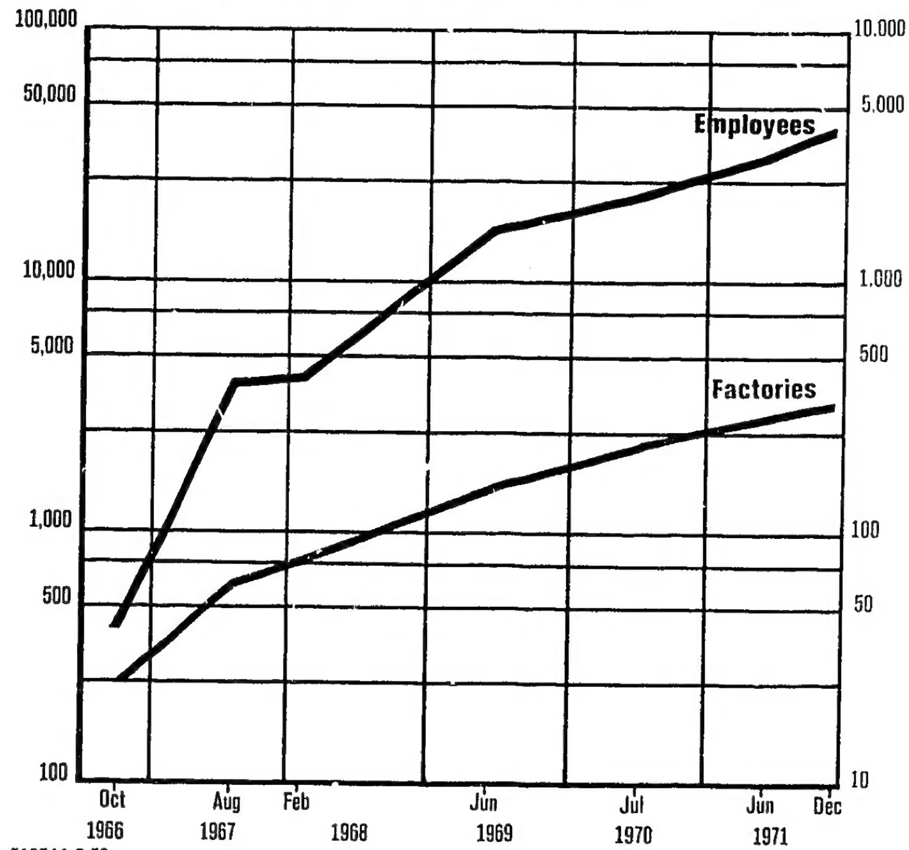
BIP in Operation

5. The BIP was received enthusiastically by businessmen and public officials on both sides of the border. As the various Mexican cities competed for factories, industrial parks were established and semi-official

development-promotion groups intensified their efforts. Chambers of Commerce in US border cities also were early and enthusiastic supporters of the program. Sparked by these promotional efforts, the number of border industry factories jumped from 25 in October 1966 to 333 in December 1971, while employment increased nearly a hundredfold – from 400 to almost 40,000 (see Figure 1). About one-fifth of the new plants

Figure 1

Border Industry Employees and Factories in Mexico . . .



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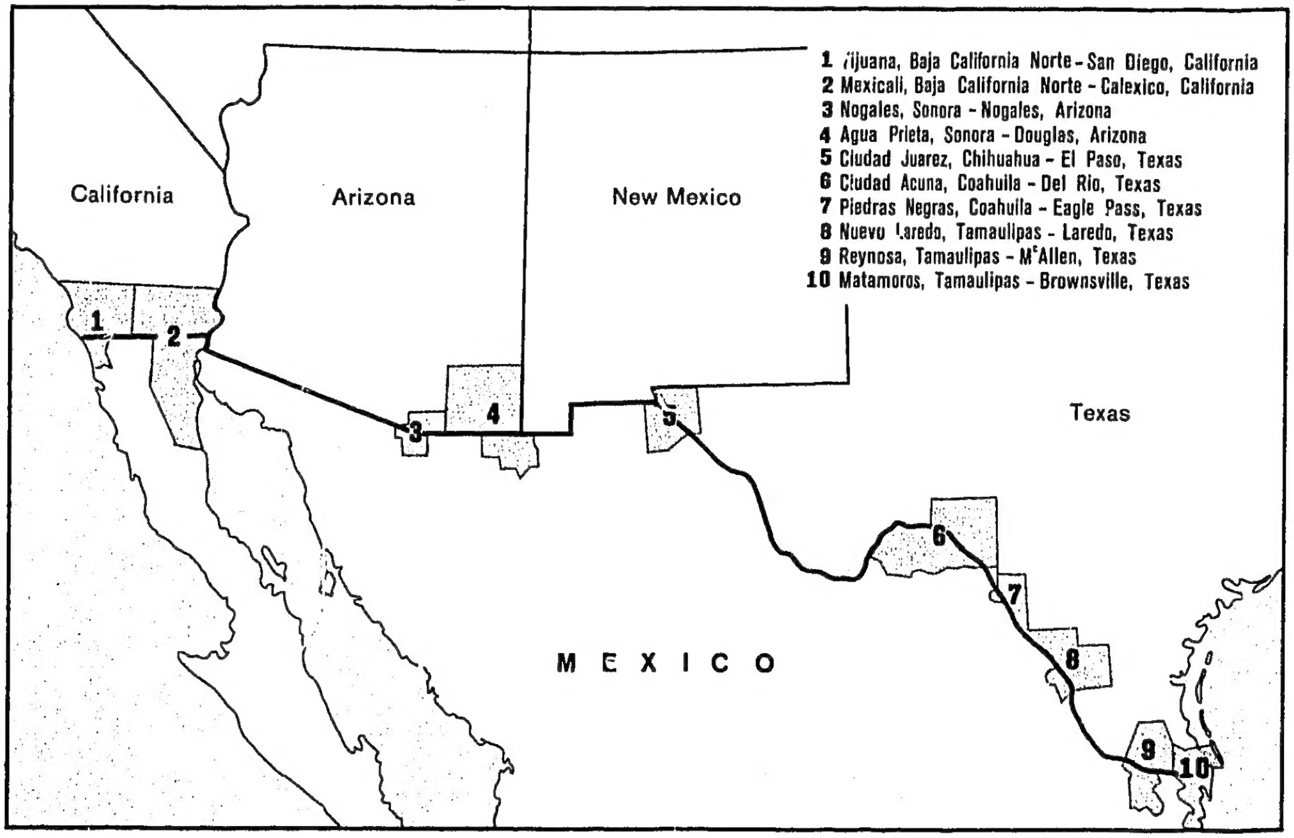
are located in the original duty-free zones, the remainder being set up in the extended zone. The majority of plants are located in the "twin city" population centers, such as Ciudad Juarez/El Paso, Nogales/Nogales, and Tijuana/San Diego (see Figure 2). The ten largest centers contain some 80% of the northern Mexican population. Owing to the program's success in attracting new factories, the Mexican government in March 1971 extended the 12-mile zone to Mexico's coasts and the border with Central America – so far, without attracting any new industrial facilities. It also granted border industry privileges to factories in the interior under certain circumstances.

Major Population Centers Along the US-Mexican Border . . . Figure 2



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Of the 333 plants with border industry status in December 1971, seven are located in the inland cities of Guadalajara, Monterrey, Torreon, San Luis Potosi, and Sabinas (see Table 1).

6. In addition to effective promotional efforts, the major factors accounting for the program's success have been Mexico's political and economic advantages compared with many other foreign countries and its low wages compared with the United States. Mexico is politically stable, has a large and easily trained labor force, and – most important – enjoys marked management, supply, and transportation advantages for re-export operations to the United States compared with more distant countries. Although wage rates in northern Mexico are among the country's highest, they are only about one-fourth of those for comparable manufacturing operations in the United States and two-thirds of those in Japan. Mexican wage rates are much higher than those in smaller Far Eastern countries with comparable political stability and trainable labor forces, such as Hong Kong and Taiwan, but the Far East's low-wage advantages are largely offset

Table 1

Mexico: Plants with Border Industry Status
December 1971

Location	Number of Plants	Estimated Employment
Northern Border Zone	326	38,100
Mexicali	67	8,800
Tijuana	86	6,000
Ciudad Juarez	37	5,000
Nogales	35	4,600
Matamoros	33	4,500
Nuevo Laredo	18	3,600
Piedras Negras	6	1,500
Agua Prieta	15	1,500
Tecate	14	1,000
Ciudad Acuna	2	800
Reynosa	3	300
San Luis Rio Colorado	3	200
Ensenada	6	200
Rio Bravo	1	100
Interior	7	1,700
Guadalajara	2	1,200
Monterrey	2	200
Torreon	1	100
San Luis Potosi	1	100
Sabinas	1	100
Total	333	39,800

by the benefits of Mexico's proximity. Comparison of wage rates (including fringe benefits) for comparable operations by employees in consumer electronics production for selected countries in 1969 is shown in the following tabulation:

	Average Hourly Earnings US $ a/
Mexico	0.53
United States	2.31
Japan	0.82
Hong Kong	0.20
Taiwan	0.13

a. Based on responses by US companies to a US Tariff Commission questionnaire reported in Tariff Commission Publication 339, Economic Factors Affecting the Use of Items 807.00 and 806.30 of the Tariff Schedules of the United States, September 1970, UNCLASSIFIED.

Because of a more rapid growth in hourly earnings in Far Eastern countries since 1969 and because of the recent currency realignment, the gap between Mexican wage rates and those in the smaller Far Eastern countries has narrowed slightly and Mexico's wage advantage over Japan has increased.

7. Some 85% of the BIP plants are US-owned, the remainder being owned by Mexican citizens. About 40% produce electrical or electronic products and 27% produce clothing and other textile products. Metalworking plants make up about 9%, furniture and wood products factories 6%, and plants producing a variety of processed foods, leather goods, and plastic products (mostly toys) 18%. Although these plants apparently are increasing their sales to third-country markets, the United States still is the focal point of their operations.

8. Almost all the US-owned BIP factories were established to perform highly labor-intensive operations that do not change the basic form of the US material or components involved. As a result, a very large share of BIP sales under US exemptions, particularly those provided in TSUS 807.00, qualifies for duty-free entry. The value of duty-free exports to the United States has remained consistently at almost two-thirds of total BIP sales under these exemptions, compared with about 55% for similar plants in Hong Kong and 25% in Taiwan. In 1970, Mexico accounted for more than one-half of US duty-free imports of this type from less developed countries,(1) exceeding by almost 50% the combined total from Hong Kong

1. Developed countries also take advantage of exemptions provided under TSUS 807.00 and 806.30 and, in aggregate, accounted for 40% of US duty-free imports of this type in 1970. Their use of these exemptions is totally different in nature, however. Most of the products involved are their own manufactures, containing only small amounts of US components which are used mainly because they are competitively priced items involving advanced technology. As a result, only 14% of the value of developed countries' sales under these exemptions qualified for duty-free entry in 1970.

and Taiwan – the second and third ranking countries. Mexico's share has been steadily rising, and it almost certainly accounted for an even larger portion in 1971.

Benefits from the Program

9. The BIP has brought substantial economic gains to the Mexican economy. Border industry exports have been a major dynamic element in the country's otherwise lackluster export performance in recent years. Although no adequate measure of total BIP exports is available, a rough estimate of their growth can be derived from the rapid rise in border industry sales to the United States invoking TSUS 807.00 and 806.30. These sales rose from $19 million in 1967 to an estimated $375 million in 1971 (see Table 2) and helped to boost the share of manufactured goods from one-fourth to about 45% of total Mexican exports – by far the largest share in Latin America. In fact, the best estimates of total BIP output in 1971 approximate $500 million, most of which was sold in the United States. Of course, the contribution of the BIP to economic activity in Mexico is far below this figure. Mexico's 1971 BIP exports to the United States under the duty exemptions were produced from a minimum of $250 million in materials and components imported from the United States, leaving about $125 million for value added in Mexico. The estimated total value of $500 million in BIP output in 1971 probably required about $325 million in foreign supplies, nearly all from the United States. Nevertheless, even on a net basis, Mexico's earnings from the BIP have helped significantly to slow the worsening in its trade balance in recent years.

10. Border industry firms have also contributed greatly to increased income and employment in the northern border area. The program has been less successful, however, in alleviating the specific unemployment problems it originally aimed at. About 85% of the new jobs are filled by women, mostly new labor force entrants, whereas many of the farm workers left unemployed by termination of the bracero program have benefited only indirectly, if at all. Moreover, the program's publicity appears to have induced a substantial movement of workers into the border area from other parts of Mexico. Consequently, although many new jobs have been created, unemployment rates in the area probably have not declined much.

11. The United States also has benefited significantly from the program. US border cities have gained from expanded investment and increased employment in office, warehousing, and component-producing facilities to support border industry operations. They have also benefited from increased retail sales resulting from the higher incomes of Mexican citizens in the northern border area. Although the movement of US factories across the border may have cost some US jobs, some of these factories would have closed down even in the absence of the BIP because of their

Table 2

Mexico: Increasing BIP Role in Foreign Trade

Million US $

	1967	1968	1969	1970	1971 Esti-mated
Exports	1,133	1,272	1,428	1,399	1,430
Manufactured goods a/	292	337	450	510	620
Of which:					
Border industry b/	19	73	145	220	375
Other goods	841	935	978	889	810
Imports	1,748	1,960	2,070	2,456	2,410
Of which:					
Border industry b/	12	50	98	138	250
Trade balance	-615	-688	-650	-1,057	-980

a. Including goods not classified in Mexican statistics, nearly all of which are manufactures; excluding raw sugar, which in Mexican statistics is included under manufactured goods.
b. Including only border industry exports to and imports from the United States as derived from US data on trade flows under TSUS 807.00 and 806.30.

inability to compete with imports. Others would have been forced to move to more distant countries where the ratio of their purchases of US-produced materials to sales would have been significantly lower. To the extent that the program has permitted US firms to compete more effectively with imported goods produced by firms not using US materials, the United States has enjoyed additional indirect trade balance gains as well.

Potential Threats to the Program

12. The BIP directly conflicts with basic principles of Mexican economic policy: that Mexican industry should be Mexican-owned, that it should use Mexican-produced material inputs, and that the border areas should be integrated economically with the rest of the country. Although these principles have often been bent for practical reasons, such deviations have usually been temporary and there is no doubt that the government still has reservations about the BIP. President Echeverria recently emphasized that the government was supporting the program "for the time being, temporarily," and Industry and Commerce Secretary Torres Manzo called it "a necessary evil." Although pragmatic considerations thus far have brought a broadening of the program, there have been hints that the BIP eventually may be constrained by Mexican regulations requiring use of domestically-produced material inputs and increased Mexican ownership. Such regulations, if they were as stringent as for other types of Mexican industry, could sharply reduce the competitive edge Mexico has over other countries as a location for re-export operations for the US market and thus limit Mexican gains from the program.

13. Rising wage rates also could narrow Mexico's competitive edge in luring re-export operations for the US market, although so far they have not done so. The new 1972-73 minimum wage scales average 18.3% above those for 1969, and wage costs have been boosted further by a 5% payroll tax adopted in 1971 for financing the National Housing Fund. These increases, although greater than in many Caribbean countries, are below those in Hong Kong and Taiwan during the period. Increased unionization is a source of potential difficulties; more than half the border industry factories are now unionized. So far there have been few labor conflicts in the northern border area, but labor militancy reportedly has been a major factor limiting border industry growth in a few cities such as Reynosa and Nuevo Laredo.

14. Perhaps the most immediate threat to the program is external, however. Organized labor groups in the United States long have opposed the import duty exemptions provided by TSUS 807.00 and 806.30. Spurred by recently increased unemployment, they are now lobbying vigorously for their elimination. The Hartke-Burke bill, currently being considered by the US Congress, would repeal these exemptions. The Mexican border industries are a prime target of US organized labor not only because they are by far the largest foreign beneficiaries of TSU 807.00 but also because of the labor-intensive nature of their operations. Labor spokesmen point to the transfer of more than 100,000 job opportunities abroad as the overall impact of US duty exemptions, but they are most concerned about the processing and assembling operations in the less developed countries.

Outlook and Conclusions

15. Barring a major change in Mexican BIP policy or repeal of US import duty exemptions, border industry investment, employment, and foreign sales seem likely to continue expanding rapidly. Should BIP sales come to dominate Mexican exports to the United States in the next two or three years, Mexico's concern about its vulnerability to US restrictions would increase. But, as border industry plants become more firmly established and increased efficiency enhances their competitiveness in other foreign markets, their orientation to re-export operations for the US market could decline somewhat. To the extent that third-country markets are developed, BIP plants would also be able to shift from US-produced material inputs to lower-cost supplies. At the same time, investment in BIP plants by Mexican and other non-US firms probably will increase, in part because of the recent world currency realignment. For example, the yen revaluation has helped to stimulate Japanese interest in the BIP, and Japanese businessmen are expected to establish several factories in the border zone during 1972 to produce for the US and other Western Hemisphere markets.

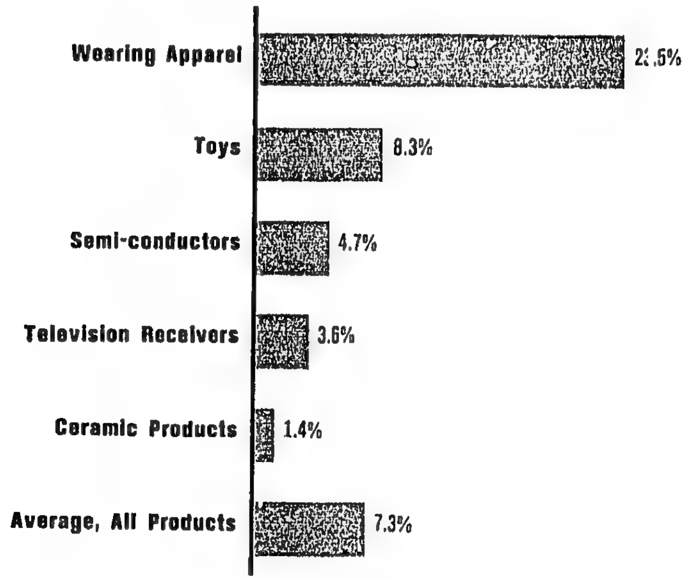
16. Because of Mexico's large and growing dependence on the border industries, the government seems unlikely to jeopardize the program by applying "Mexicanization" or other restrictions to the border industry plants or by unduly increasing minimum wages in the next several years. Indeed, despite government officials' publicly expressed misgivings about the program, the March 1971 extension of the border area seems to indicate growing official recognition of BIP's contribution to the Mexican economy. Thus, although a few new restrictions probably are inevitable, strong – albeit tacit – official support seems likely over the next several years.

17. Repeal of US import duty exemptions would greatly set back, although not destroy, the BIP. Because of the rise in duty-paid costs of their products in the US market (see Figure 3), a number of US-based firms would suspend their processing and assembling operations in Mexico. About one-third of the present BIP plants could be so affected.(2) Producers in the clothing, leather, and electronics industries would be particularly vulnerable because they face the most severe competition from imports less dependent on US-produced materials and components. In fact, because the value added in BIP clothing and leather plants is relatively small and US duty rates on their products are high, the rise in duty-paid costs on these exports to the United States would be so marked as to force almost a total shut-down in operations of this type. Overall, repeal of US duty exemptions would mean a loss to Mexico of an estimated 115-130 border

2. The basis for this estimate and others in paragraphs 17 and 18 is discussed in greater detail in the Appendix.

Figure 3

Increases in Cost of US Imports from Mexican Border Industries that Would Result from the Repeal of US Tariff Section 807.00* . . .



*Estimated at 1972 Kennedy Round import duty rates. Data apply to estimated increases in duty-paid cost of the final product in the US market. The rise in the costs of using US materials in Border Industrialization Program operations would be considerably higher.

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industry factories employing some 8,000-10,000 Mexican citizens and accounting for $65 million to $85 million in gross export earnings. About one-fourth to one-third of these plants might move to the Far East or the Caribbean area to obtain greater labor-cost savings, while the remainder would return to the United States or simply close down.

18. With repeal, benefits now accruing to the United States from the BIP would also decrease sharply. Retail sales in US border cities would suffer as a result of reduced employment on both sides of the border. Moreover, decline in employment in office, warehousing, and component-producing facilities in the United States would offset most – if not all – of the gains deriving from the return of some BIP operations. Because many of the border industry plants remaining in operation would have little incentive to use US materials, they almost certainly would shift to lower-cost supply sources. Such replacement, together with losses from the transfer or closing of other BIP plants, would reduce the current level of US material sales to Mexico by an estimated $50 million in the first transitional year and by $125 million to $165 million in subsequent years. Because the United States nevertheless would continue to be the major market for BIP sales, repeal of the import duty exemptions in fact would

worsen the US trade balance with Mexico, perhaps by $70 million annually. Increased sales to Far Eastern or Caribbean countries, where some BIP plants would be re-established, could be expected to make up only a small fraction of this loss.

APPENDIX

Effects of Repeal of TSUS 807.00 and 806.30 on Border Industry Operations

Materials used in measuring the impact of repeal of TSUS 807.00 and 806.30 include (a) detailed data on 1970 BIP exports to and imports from the United States under TSUS 807.00 and 806.30 as compiled by the US Department of Commerce; (b) analysis of US firms' responses to questionnaires distributed by the US Tariff Commission, as reported in US Tariff Commission Publication 339, **Economic Factors Affecting the Use of Items 807.00 and 806.30 of the Tariff Schedules of the United States,** September 1970; and (c) various Embassy reports on BIP operations. In case of repeal, we estimate that after the first transitional year the following reductions would occur in operating BIP plants, BIP employment, Mexican purchases of US materials and components, and Mexican exports to the United States, by product line:

Product	Number of Plants	Number of Employees	Purchase of US Materials (Million US $)	Exports to the United States (Million US $)
Electrical and electronic products	15-25	1,100-2,500	80-100	25-35
Clothing, textile, and leather products	95-100	6,600-7,000	25-35	40-50
Toys	0	0	20-30	0
Other products	5	300-500	Negl.	Negl.
Total reductions	115-130	8,000-10,000	125-165	65-85

Electrical and Electronics Products

Most of the 130 to 135 BIP electrical and electronic products plants assemble components and final products for use or sale by their parent US firms in the US market. Their principal products include semi-conductors, electronic memories, television receivers and parts, and office machines and parts. Many of the BIP plants producing electronic components are integral parts of US production lines and are tied to use of parent company materials. Since the labor-cost advantages of BIP operations generally exceed the relatively small duties saved by the exemptions on these products, most would continue operation following repeal. A few -- perhaps ten -- small plants that are not subsidiaries of

US firms and could not absorb a 5% duty on re-exports of materials and components to the United States probably would be forced to close, however. Possibly an additional ten or so large plants – subsidiaries of US firms that also have plants in the Far East – probably would be closed and their operations transferred there.

Plants assembling television receivers and office machines and parts, which account for an estimated one-half of 1971 BIP purchases of electrical and electronic materials from the United States, probably would gradually eliminate these purchases following repeal. These plants presently buy US-made materials, although non-US materials of comparable quality are readily available at lower prices and they are generally free to buy them. Overall, repeal of the exemptions would reduce the number of BIP plants producing electrical and electronic products by an estimated 15 to 25, cut BIP employment by some 1,100 to 2,500 workers, and reduce annual BIP imports from and exports to the United States by an estimated $80 million to $100 million and $25 million to $35 million, respectively.

Clothing, Textiles, and Leather Products

About half of the 90 or so BIP clothing and textile plants and all of the ten or so leather products plants are small assemblers of low-priced articles for sale through large US chains in direct competition with US imports from Far Eastern countries not using TSUS 807.00 exemptions. The other half of the clothing plants are affiliated with large US producers of high-quality lingerie and other goods that do not face significant Far Eastern competition. Application of the 34% duty on re-exports of US textile materials and the 12% to 18% duties on leather materials would make continued operation by all these BIP plants wholly unprofitable. While possibly as many as 40 clothing plants -- mainly those associated with the large US firms -- might shift operations back to the United States and perhaps 20 might transfer to the Far East or Caribbean area, the remaining clothing and all of the leather plants probably would simply close down. Transfer and closure of these plants would reduce BIP employment by at least 6,600, imports of US materials by $30 million or so annually, and exports to the United States by some $45 million annually.

Toys

Nearly all the BIP toy plants assemble final articles from materials purchased from independent US producers for sale in the US market by one large US firm (Mattel). Generally, the labor cost advantage of BIP operations exceeds the margin of duty saved, and the plants probably would remain in operation following repeal. Because of the flexibility of material supply and the ready availability of non-US materials of comparable quality

at lower prices, however, it is estimated that the 18% rise in the cost of using US materials following repeal would result in a complete shift to non-US materials. Therefore, the impact of repeal on the toy plants would reduce BIP purchases of US materials by an estimated $25 million or so annually while leaving toy exports to the United States unchanged.

Other Products

The adverse impact of repeal on the remaining 90-odd BIP plants would be generally small. Mostly small metal, ceramic, wood-working, and food-processing operations, they account for a total of only about 15% of BIP exports to the United States under the exemptions. Although the value added by these plants is relatively small, their labor-cost savings from BIP operations nevertheless generally exceed the margin of duty saved, and their operations would in most cases remain unchanged following repeal. The 20-odd furniture and wood products plants in this group would face an 8% duty on re-exports to the United States, however, and thus perhaps about five would close, reducing BIP employment by 300 to 500 workers but having a negligible effect on BIP imports from and exports to the United States under the exemptions.